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SUBJECT: ASSET STRUCTURE OF KAZAKHSTAN'S NATIONAL OIL AND GAS
COMPANY KAZMUNAYGAS

Summary

¶1. (U) KazMunayGas (KMG), Kazakhstan's state-owned oil and gas company, is a vertically integrated company holding 25 subsidiaries in oil and gas exploration, extraction, processing, transportation, and sales. KMG produces 16% of Kazakhstan's oil output, transports 65% of its oil, and manages 100% of the country's gas trunk pipelines, 50% of its tanker transportation, and 30% of its oil refining facilities. End Summary.

Background Information

¶2. (U) KMG was founded in February 2002 from a merger of two national companies, KazakhOil and Transportation of Oil and Gas (itself a result of the 2001 merger of KazTransOil and KazTransGas). In 2006, KMG became a 100%-owned subsidiary of the newly organized State Assets Management Holding Company "Samruk." Kazakhstan's Law on Subsoil Use gives KMG the pre-emptive right to acquire 50% stakes in new and existing projects in the case of an equity transfer.

KMG's Relationship with Energy Ministry and Samruk

¶3. (U) The Ministry of Energy and Mineral Resources provides policy supervision for KMG, establishes development priorities in the oil and gas sector, and identifies the role of KMG in this development. Moreover, the Energy Ministry dictates the rules of Kazakhstan's energy market, regulates the market of oil products, keeps a register of subsoil users, and controls the compliance of subsoil users with technical standards.

¶4. (U) Samruk coordinates the work of KMG and is responsible for its strategic management. Samruk does not interfere with the operating activities of KMG, but establishes its strategic development priorities, such as corporate management, budgeting, and some aspects of the relationship with investors and the state. Samruk has the right to include its representatives on the KMG board of directors.

¶5. (U) Samruk plans to restructure KMG. According to Samruk chairman Kanat Bozumbayev, KMG is affiliated with over 190 companies, 40% of which are classified as non-core assets (not directly related to the company's profile operations) in education, mass media, construction, etc. Examples include Kazakhstan-British Technical University, Rauan Media Group, and KazMunayGas-Service. He envisions that in 2008-2010, about 100 such companies will be sold. In 2002-2006, KMG sold some of its non-core assets such as KazTransCom, KazStroyService, KarakudukMunay, KazakhstanCaspiShelf, KMGPromGeoPhizika, KMG Consulting, and others.

KMG Major Projects

¶6. (U) Of major oil and gas projects, KMG holds a 20% stake in TengizChevrOil operating consortium, represents state interests in the Caspian Pipeline Consortium and in the Karachaganak project, and has increased its share from 8.33 to 16.81% in the consortium developing the Kashagan field.

¶7. (U) KMG also holds a 50% stake in KazakhOil-Aktobe (the other 50% belongs to Russia's LukOil Overseas company), a 51% stake in KazakhTurkMunay (Turkish Oil Corporation holds 49%), 33% in PetroKazakhstan company (China National Petroleum Corporation CNPC controls the other 67%), and a 34% stake in the KazakhOil-Ukraine joint venture.

¶8. (U) KMG has several projects connected with the Karachaganak field. The company owns a 50% stake in KazRosGas, a joint venture with Russia's Gazprom company based at Orenburg Gas Processing Plant (GPP). The plant refines and then exports Karachaganak gas. As a part of this joint venture, KMG is seeking a 50% stake in the Orenburg GPP. KMG is also completing a feasibility study to build a Karachaganak-supplied gas refinery at Aksai that will meet the internal demand for gas.

KMG Subsidiaries

¶9. (U) Among the most significant of KMG's 25 subsidiaries, Exploration&Production KazMunayGas carries out production projects, KazMunayTeniz manages offshore projects, the Kazakhstan Oil and Gas Institute assesses all KMG field exploration and hydrocarbon transportation projects, KazTransOil supervises oil pipeline transportation, KazTransGas manages domestic and international pipeline shipments of gas, KazMorTransFlot ships oil across the

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Caspian Sea via tankers, and Trade House KazMunayGas processes oil, exports oil and oil products, and sells oil products to the domestic market.

KMG Production Subsidiary Assets

¶10. (U) KMG owns 61% of Exploration&Production KazMunayGas (EP KMG), while the remaining 39% is traded on the London and Kazakhstan stock exchanges. In 2007, EP KMG acquired a 50% stake in KarazhanbasMunay, which is developing the Karazhanbas oil field (403.15 million barrels of oil in probable reserves) in Mangistau Oblast, and a 50% stake in KazGerMunay, which is developing the Nuraly, Aksai, and Akshabulak oil fields (317.38 million barrels of oil in proven reserves) in Kyzylorda Oblast. EP KMG also has two production subsidiaries, EmbaMunayGas and UzenMunayGas, which hold more than 1.5 billion barrels of recoverable reserves.

¶11. (U) EP KMG also holds a 50% stake in Kazakhstan Petrochemical Industries (KPI), with SAT & Company holding the other 50%. KPI is constructing in Atyrau Oblast the Karabatan petrochemical complex, which will have an annual capacity of 0.8 million tons of polyethylene. The facility will receive 6 billion cubic meters (bcm) of gas from Tengiz, and 3 bcm from Kashagan. On May 28, 2008, EP KMG provided 4.8 billion tenge (\$40 million) to select engineering and construction contractors.

¶12. (U) After a new tax code comes into effect on January 1, 2009, EP KMG will reportedly seek to buy 50% shares in KazakhOil-Aktobe, 51% in KazakhTurkMunay, 33% in PetroKazakhstan from KMG, and at least a 51% stake in MangistauMunayGas (MMG) from Indonesia's Central Asia Petroleum Corp. (Note: EP KMG is waiting for the new tax code in order to measure the effect on its revenues and expenditures. In the second half of 2008, EP KMG will start due diligence of upcoming acquisitions. End Note.) MMG, the fifth largest oil producer in the country (accounting for 9% of Kazakhstan's oil output), possesses 36 associated fields with 7.03 billion barrels of oil in estimated reserves. MMG owns Helios brand gas stations and holds a 54.8% stake in Pavlodar Oil Refinery.

¶13. (U) In 2009, EP KMG plans to launch the production of road bitumen at the Aktau Plastic Products Plant, in which it owns a 50%

stake (SAT & Co is the other shareholder). In 2010, EP KMG will start production of aromatic hydrocarbons at the Atyrau Polyethylene Plant. EP KMG owns a 50% stake of the plant.

¶14. (U) In June 2008, EP KMG expressed interest in purchasing a 50% stake in Turgai Petroleum Joint Venture, currently owned by LukOil and PetroKazakhstan (controlled by CNPC), soon after LukOil announced its intention to buy out CNPC's share. Turgai Petroleum is developing the Kumkol oil field, which has approximately 170 million barrels of oil in proven reserves.

Assets of KMG Offshore Project Managing Subsidiary

¶15. (U) The 100%-owned KMG subsidiary KazMunayTeniz (KMT) holds a 40% stake in Caspi Meruerty Operating Company B.V. (CMOC), which is exploring the Zhemchuzhina oil field along with Shell and Oman Pearls Company Ltd, and a 25% stake in the Zhemchuzhina Production Sharing Agreement (PSA).

¶16. (U) KMG intends to establish a joint venture with Lukoil and Gazprom to develop the Tsentralnaya section of the Caspian shelf with 300 million tons of hydrocarbons in estimated reserves. KMG is close to signing with the Ministry of Energy and Mineral Resources a contract for exploration and extraction of hydrocarbons at the Mertvyi Kultuk offshore section with estimated reserves of 1.2 billion barrels of oil, 97.5 bcm of gas, and 5.1 million tons of gas condensate.

¶17. (U) The first drilling results of the Atash field jointly explored by KMT and LukOil showed no oil and gas reserves present (the field was expected to have 1.03 billion barrels of oil). This is the third failure of KMT, following the Tyub-Karagan and Kurmangazy offshore projects. Moreover, according to some experts, the Khvalynskoye field explored by the KMG-LukOil Joint Venture, Caspian Oil and Gas Company, was also not as promising as had been expected. EP KMG seeks to replace KMT as operator of offshore projects, as it claims to possess more technical expertise in field development.

¶18. (U) In May 2008, KMG signed a contract to explore the Zhambyl section of the Caspian shelf, which has over 120 million tons of hydrocarbons in probable reserves. KMT will have 73% of the project, and Korea National Oil Corp. the remaining 27%. In January 2008, KMG also signed a PSA with the Ministry of Energy and Mineral

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Resources to explore the promising N (or Nursultan) section of the Caspian shelf (600-700 million tons of hydrocarbons in probable reserves). (Note: This is the block that ConocoPhillips and Shell competed for. ConocoPhillips and Shell both hope that they will eventually be provided an opportunity to participate.)

Projects of KMG Oil Pipeline Transportation Subsidiary

¶19. (U) The 100%-owned KMG subsidiary KazTransOil (KTO) has a 50% stake in the Kazakhstan-China Pipeline Ltd, with the other 50% belonging to China National Oil and Gas Exploration and Development Corporation. In 2006, KTO started oil shipments via the first stage of Kazakhstan-China oil pipeline Atasu-Alashankou. Kenkiyak-Kumkol, the second stage of the pipeline, is to be launched at the end of ¶2009.

¶20. (U) In December 2006, KTO and its partners, Naftrans (owned by Danish Greenoak Holdings Ltd and ENR Russia Invest) and French bank BNP Paribas, established a joint venture based at Georgia's Batumi oil terminal. In 2007, KTO acquired the stakes of its partners and became the sole owner of the terminal. KMG is interested in increasing its transit volumes of oil to 10 million tons a year via Georgia's railroad and oil pipelines.

Projects of KMG Gas Pipeline Transportation Subsidiary

¶21. (U) The 51%-owned KMG subsidiary KazTransGas (KTG) owns

Intergas Central Asia company, Amangeldy Gas company (gas extraction and processing in the Amangeldy field), and KazTransGas LNG (operator of Zhanazhol gas field), and also holds a stake in the Kazakhstan-Kyrgyzstan joint venture KyrKazGas. In 2006, KTG bought Georgian Gas Distributing Company Tbilgasy.

¶22. (U) KTG holds a 50% stake in the Asian Gas Pipeline LLP, a joint venture with the CNPC affiliate, Trans-Asia Gas Pipeline Ltd. The joint venture was established in February 2008 to build a Kazakhstan-China gas pipeline with an annual capacity of 40 bcm of gas. To ensure gas supply to this pipeline, the Government of Kazakhstan transferred to KMG the Urikhtau gas field in Aktobe Oblast with probable reserves of 40 bcm of gas.

Operations of KMG Tanker Transportation Subsidiary

¶23. (U) KazMorTransFlot (KMTF) owned by Samruk (50%) and KMG (50%) is the national maritime trade fleet. KMG seeks to increase its stake in KMTF to 100%. KMTF has its own support fleet, including the tankers "Astana," "Almaty," and "Aktau," and ships oil via tankers to the sea ports of Makhachkala (Russia), Baku (Azerbaijan), and Necca (Iran).

Assets of KMG Processing and Sales Subsidiary

¶24. (U) The 100%-owned KMG subsidiary Trade House KazMunayGas (TH KMG) holds stakes in three oil refineries, Atyrau (99.09%), Shymkent (50%), and Pavlodar (42%). KMG seeks to increase its stake in the Pavlodar Oil Refinery after the planned acquisition of at least a 51% stake in its co-owner, MangistauMunayGas. KMG owns 20.2% of Ukraine's Kherson Oil Refinery, but wants to raise its share to at least 50%.

¶25. (U) TH KMG sells oil products via the 156 gas stations of its daughter companies KMG-Alatau, KMG-Astana, and KMG-Zhaiyk. By 2010, KMG plans to have 330 gas stations, or 15% of all gas stations in the country. In 2007, TH KMG acquired a 75% stake in Rompetrol Group N.V., which has two oil refineries in Petromedia and Constanta and 630 gas stations in Romania, France, Spain, Moldova, Ukraine, and Bulgaria. Rompetrol ships oil to Turkey, Ukraine, Croatia, and Moldova, and has a five-year contract for lease of tankers.

Comment

¶26. (U) KMG employs over 30,000 employees and accounted for 8.55% (or \$1.58 billion) of Kazakhstan's 2007 budget revenues. A diversified structure with both core and non-core assets makes KMG a low-risk and solvent client in the eyes of potential lenders as its assets are well diversified, and hence losses of a company in one sector can easily be compensated with gains of those in another. However, the heavy bureaucratic structure of KMG also creates a number of problems - a lack of financial and operational transparency, potential misuse of funds (e.g. funds allocated to a core company can be used by a non-core company), difficulties in controlling cash flow, high interdependence of companies, and

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reduced efficiency of operative management. KMG is awaiting further restructuring and administrative reforms to make it more easily manageable, transparent, and more streamlined.

¶27. (U) Maksat Idenov has briefed USG officials on several occasions on his plans to restructure KMG along the lines of an integrated IOC, based in part on his experience as a senior executive with Shell. With the removal of KMG President Karaballin, after Karaballin's unsuccessful attempt to force Idenov out, and with the apparent backing of the President and Prime Minister, Idenov has at least some room to implement his restructuring plans.